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Supreme Court of the United States

OCTOBER TERM, 1955

No. 226

WILLIAMS-McWILLIAMS INDUSTRIES, INC.,
Appellant

versus

ALEX McKEIGNEY,
Chairman, State Tax Commission,
Appellee

On Appeal from the Supreme Court of Mississippi

JURISDICTIONAL STATEMENT

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JURISDICTIONAL STATEMENT

Appellant submits this statement to show that the instant appeal is within this court's jurisdiction, and that the question presented is both substantial and important.

Opinions Below

The opinion of the Supreme Court of Mississippi appears at 86 So.2d 672. The opinion of the Chancery Court of the First Judicial District of Hinds County, the court of first instance, has not been reported. Both opinions are printed in the appendix at pages 18 *ff* below.

Jurisdiction

This suit was brought, pursuant to section 9220-31, chapter 1, title 36. Mississippi Code (1942), to review the validity of a state income-tax assessment. The judgment of the Supreme Court of Mississippi was rendered on April 16, 1956. Rehearing was denied on May 7. The notice of appeal was filed in the Supreme Court of Mississippi on May 29, 1956.

This court has jurisdiction of the appeal under 28 USC 1257(2). See *Hans Rees' Sons vs North Carolina*, 283 US 123 (1931); *Atchison Ry. Co. vs Public Utilities Commission*, 346 US 346 (1953); *Fiske vs Kansas*, 274 US 380 (1927); *Dahnke-Walker Co. vs Bondurant*, 257 US 282 (1921); *Merchants' Nat'l Bank vs Richmond*, 256 US 635 (1921); *Schlemmer vs Buffalo, Rochester & Pittsburg Ry. Co.*, 205 US 1 (1907).

Statutes Involved

The appeal involves the validity, as applied in this case, of section 11(1)(c) of the Mississippi Income Tax Act;[1] and of article 247 of Regulations 9 of 1949 and 10 of 1952 promulgated thereunder.[2] The texts of these provisions are set out in the appendix at pages 38 *ff* below.

Question Presented

This appeal presents this question:

> May an Illinois corporation which has its executive offices and operational headquarters in Louisiana, which conducts a unitary multi-state business, and which is engaged in interstate commerce, be taxed by Mississippi on its entire net income realized directly from dredging work done in Mississippi, even though operations in other

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[1] This section is precisely the same in the Income Tax Act of 1934, Chapter 120 of the General Laws of Mississippi, 1934, which applies to the taxes in suit for 1951; and in the Income Tax Act of 1952, Chapter 402 of the General Laws of Mississippi, 1952, which applies to the taxes in suit for 1953. The section of the 1934 Act appears on page 192 of the General Laws of Mississippi, 1934; on page 132 of the General Laws of Mississippi, 1936; and, as section 9231(1)(c), chapter 1, title 36, on page 78 of volume 7 (1942, superseded) of the Mississippi Code (1942) Annotated. The section of the 1952 Act appears on page 619 of the General Laws of Mississippi, 1952; and, as section 9220-12(1)(c), chapter 1, title 36, on page 108 of volume 7 (recompiled, 1952) of the Mississippi Code (1942) Annotated.

[2] The cited article is the same in both regulations. Article 247 appears on pages 149-52 of the official pamphlet edition of Regulation 9 of 1949; on pages 150-54 of the official pamphlet edition of Regulation 10 of 1952; and in the record as Exhibits 5 and 6 to the answer. For purposes of this court's jurisdiction, these regulations are "statutes". See *Atchison Ry. Co. vs Public Utilities Commission*, 346 US 346 (1953); *Hamilton vs Regents*, 293 US 245 (1934); *Sultan Ry. Co. vs Department of Labor*, 277 US 135 (1928).

states were equally necessary to production of such income; or is not Mississippi, on the contrary, restricted by the due-process and commerce clauses of the Federal Constitution to taxation of that part only of the corporation's net income which may fairly be ascribed to activities pursued in Mississippi?

This court has in recent years had occasion to consider, in a number of contexts, the extent of the powers of the states to tax multi-state business operations. Two constitutional principles of general application have evolved from this court's holdings: (1) the due-process clause forbids taxation by one state of values properly attributable to another; and (2) the commerce clause forbids taxation which exposes interstate commerce to imposition of taxes by more than one state on the same subject or event.

The decision by the Supreme Court of Mississippi in the case at bar is in apparent conflict with both of these principles, particularly as they have been applied by this court to state net-income taxation.

The decision is in direct conflict, on these constitutional issues, with a decision by the Supreme Court of Kansas in which the pertinent holdings of this court were applied correctly.

The result of the decision below is contrary to that reached, by statutory construction, by other state supreme courts, the result of whose decisions is in harmony with the holdings of this court. The holding below is apparently supported by only one other decision, of doubtful application to the issues in this case.

The Facts

a

Definitions

At the outset, certain terms used in this statement are defined. A "unitary" business, for present purposes, is one consisting of several interrelated phases, not all of which are directly productive of income, but all of which are necessary to production of the income.

A typewriter manufacturing business may consist of purchase of raw materials, fabrication and assembly of parts, warehousing, distribution and sale of typewriters.[3] An ale business may consist of selection and purchase of raw materials, chemical processing, bottling, storage, distribution and sale of ale.[4] A wholesale chain-store business may consist of purchase of manufactured products, warehousing, distribution and final resale through multiple outlets.[5]

In each case, income is produced directly only by the final phase of operations, the sales. Obviously, the entire profits of the unified enterprise are not attributable to the sales alone. Each phase of the business is necessary to the ultimate result; and the profits are attributable in some proportion to all.

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[3] See *Underwood Typewriter Co. vs Chamberlain*, 254 US 113 (1920).

[4] See *Bass, Ratcliff & Gretton vs State Tax Commission*, 266 US 271 (1924).

[5] See *Butler Bros. vs McColgan*, 315 US 501 (1942); *Montgomery Ward & Co. vs State Tax Commission*, 151 Kans. 159, 98 P2d 143 (1940). Publication of a newspaper has been held to be a unitary business: *Re Kansas City Star Co.*, 346 Mo. 658, 142 SW2d 1029 (1940).

The existence of multi-state unitary businesses has led to difficult problems of state taxation, an important aspect of which is involved in this case. At this point, it suffices to say that there are two principal methods for taxing the net income of multi-state enterprises.

One method is to seek to identify and tax the particular income actually realized in the state. This method, sometimes called allocation, direct accounting or multiform taxation, is referred to herein as specific accounting.

The other method is to take the entire net income, wherever derived, and to apportion it on a formula basis among all of the states in which phases of the business are conducted. This method, also sometimes confusingly called allocation, is referred to herein as apportionment.

b

Appellant's Operations

The appellant Illinois corporation is in the dredging business.[6] Its main business office is in New Orleans. That office provides appellant's executive management. Operations are planned and given overall supervision there; finances, accounting and tax matters are handled there; appellant's civil and mechanical engineering staffs have their operational headquarters and perform their

[6] On December 31, 1955, Williams-McWilliams Industries, Inc., a Delaware corporation, succeeded by merger to the assets and business of McWilliams Dredging Company, the Illinois corporation which brought this suit. Tr 328. For simplicity, the term "appellant" is used herein to describe McWilliams Dredging Company, in which name the successor corporation is continuing to conduct that company's business.

principal functions of design and planning there; tools, parts, fuel and other supplies (except minor expendable items) are purchased there; and, generally, all major decisions affecting the course of the business are made in New Orleans.[7]

Appellant maintains its shipyard in Morgan City, Louisiana. All major repairs to appellant's equipment are effected in this yard. Equipment of every type, when not otherwise employed, as well as supplies and parts, are centrally stored and maintained there. A tug is headquartered there for use in bringing parts, fuel and other supplies to dredges working in other states. Major equipment, and even some vessels, are fabricated at this yard.[8]

Appellant also maintains its soils laboratory in Morgan City. At this laboratory a trained staff analyzes and evalutes samples of earth and rock formations to be dredged.[9] Such analysis is essential in estimating the cost of prospective operations.

From its base in Louisiana, appellant seeks dredging employment in that and other states. Its engineers and estimators investigate all cost factors involved in contracts to be let. Samples of the subsurface material to be dredged are sent to the soils laboratory in Louisiana for analysis. On the basis of such investigations and analyses, and of consideration of appellant's existing commitments and of the disposition and availability of its

[7] Tr 153-54, 198.
[8] Tr 96-7, 98-9, 143, 152, 155-56, 158.
[9] Tr 155.

equipment, decisions are made in New Orleans as to which projects are to be bid.[10]

Appellant is invariably engaged in dredging work in several states at the same time.[11] Interchange of equipment and personnel between projects is common.[12] Equipment is sometimes shifted temporarily from a job progressing ahead of schedule to one running behind.[13] Upon termination of work under one project, the location of the equipment is an important factor in determining the next contract to be bid, because of the great expense of "mobilizing", or assembling and moving, the extensive equipment used in dredging.[14]

Dredges and other equipment regularly cross state lines in moving from one project site to another, either permanently or temporarily, and in moving back and forth between the Morgan City yard and work sites in other states.[15]

Most of appellant's work consists in improvements of navigable waterways under contract with the United States Government.[16] Some of the work whose proceeds Mississippi seeks to tax, consisted of dredging trenches across the bed of the Mississippi River between Mississippi

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[10] Tr 153-54, 155, 198.

[11] In the years in suit appellant was working in Mississippi, Louisiana, Illinois, Arkansas, Texas, Missouri and North Carolina. Tr 96, 103, 109, 200, 202, 204-217.

[12] Tr 121-22.

[13] Tr 161.

[14] Tr 153-54, 197.

[15] Tr 158.

[16] "Our biggest customer (is) the United States Corps of Engineers." Tr 160.

and Arkansas, and between Mississippi and Louisiana, for accommodation of interstate pipelines.[17]

Although the Supreme Court of Mississippi made no finding on either point,[18] it is obvious that appellant's business is both interstate[19] and unitary.[20] While appel-

[17] Tr 79, 82-92, 96, 165, 206, 214, 215. In the years at issue, dredging was also done in the Mississippi River between Illinois and Missouri. Tr 212.

[18] This omission does not affect this court's jurisdiction: "Neither of the state courts passed upon this evidence or made findings of fact thereon; doubtless because, under their respective views of the applicable law, the facts referred to were immaterial. But this omission does not relieve us of the duty of examining the evidence for the purpose of determining what facts reasonably might be, and presumably would be, found therefrom by the state court, if plaintiff in error's contention upon the question of federal law should be sustained, and the facts thereby shown to be material." *Merchants' Nat'l Bank vs Richmond*, 256 US 635, 638 (1921).

[19] *Cf. United States vs Shubert*, 348 US 222 (1955); *National Labor Relations Board vs White Construction & Engineering Co.*, 204 F2d 950 (CA 5-1953).

[20] The trial court found that appellant's business was not unitary, but only in the sense that it was possible to determine "the taxable income derived from its operations exclusively within the State of Mississippi". Tr 295. The true criterion of a unitary business is not impossibility of determining the place of realization of its income, but the fact that its income, wherever realized, is attributable in some measure to each of the several phases of its over-all operation. See footnote 2, page 12 below; and *Montgomery Ward Co. vs State Tax Commission*, 151 Kans. 159, 98 P2d 143 (1940). Several of the businesses which this court has expressly found to be unitary, have had no difficulty in determining by standard accounting procedures exactly how much of their income was realized in each of the states in which their income-producing phases were conducted. See *Butler Bros. vs McColgan*, 315 US 501 (1942); *Underwood Typewriter Co. vs Chamberlain*, 254 US 113 (1920). The trial court's misconception of the issue at bar accordingly does not foreclose determination by this court of the real issue presented. *Cf. Craig vs Harney*, 331 US 367, 373 (1947); *Fiske vs Kansas*, 274 US 380, 385-86 (1927).

lant realizes income directly only from actual dredging work, its central management and operational functions in Louisiana are equally necessary to production of income.

Further, by reason of the interchange of equipment and personnel between projects; of the influence of the location of each project on selection of the next; and of the fact that each job—even though it may be unprofitable in itself—may contribute to the profits of the organization as a whole by helping to defray irreducible overhead expenses and facilitating quantity purchases at discount; each job contributes in some degree to the realization of every dollar which appellant earns.[21]

c

Mississippi Assessment

Against this background, appellant, in 1951 and 1953, reported its net income to Mississippi, for income-tax purposes, on an apportionment basis. In other words, acting under apparent authority of the Mississippi Income Tax Act[22] as well as decisions of this court,[23] appellant took its entire net income for 1951 (1953 was an over-all loss year) and apportioned part of it to Mississippi on the basis of a formula prescribed by the State Income Tax Act.[24]

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[21] On these grounds, this court has sustained apportionment taxation even by a state in which a multi-state unitary business suffered a loss. *Butler Bros. vs McColgan*, 315 US 501 (1942).

[22] Section 11(1)(c), printed in the appendix at page 38 below.

[23] *Butler Bros. vs McColgan*, 315 US 501 (1942); *Bass, Ratcliff & Gretton vs State Tax Commission*, 266 US 271 (1924); *Underwood Typewriter Co. vs Chamberlain*, 254 US 113 (1920).

[24] Tr 3, 12, 46-7, 58.

Because in both 1951 and 1953 work done in Mississippi resulted in substantial direct profits as compared with losses or smaller profits elsewhere, the appellee State Tax Commissioner, acting under article 247 of his Regulations 9 (1949) and 10 (1952) promulgated under the Income Tax Act, rejected appellant's returns, and assessed appellant for both years on the basis of its entire net income realized on dredging work in Mississippi, as determined by specific accounting.[25]

d

Constitutional Issues

This suit was brought to protest these assessments. In its petition in the trial court appellant averred that, as sought to be applied by appellee, the state Income Tax Act and regulations "violate Section 1 of the 14th Amendment to the Constitution of the United States providing that no State shall deprive any persons of life, liberty and property without due process of law nor deny to any person within its jurisdiction the equal protection of the law, and the 'Commerce Clause', Paragraph 3, Section 8 of the Constitution of the United States".[26]

The same averments were made by specification of error filed in the Supreme Court of Mississippi.[27] While neither court mentioned the constitutional questions, ap-

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[25] Tr 46. This resulted in levy by Mississippi of an income tax for 1953, in which year appellant's over-all operation resulted in a substantial loss (Tr 257); and in levy by Mississippi on twice the amount of appellant's entire over-all net income for 1951 (Tr 179). The cited article of the regulations is printed in the appendix at pages 38 *ff* below.

[26] Tr 10-11, 17. These averments raise a constitutional question within the jurisdiction of this court. *Dahnke-Walker Co. vs Bondurant*, 257 US 282 (1921).

[27] The pertinent specification is printed in the appendix at page 44 below.

pellant's contentions were necessarily rejected by the decision upholding validity of the Act and regulations as applied by appellee.[28]

The Question is Substantial

In a series of decisions this court has established the rule that each state in which a multi-state business operates, may impose a tax on the net income fairly attributable to operations therein. In the case of a unitary business, the profits derive from a number of phases, but are realized directly only from the last.

Each state in which a prior phase is conducted—"faced with the impossibility of allocating specifically the profits earned by the process conducted within its borders"—is entitled to adopt some reasonable method of apportionment designed to reach "the profits earned within the State".[1]

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[28] "If the (federal) question is duly raised and the judgment necessarily, or by what appears in fact, involves such a decision, then this court will take jurisdiction, although the opinion below says nothing about it." *Schlemmer vs Buffalo, Rochester & Pittsburg Ry. Co.*, 205 US 1, 11 (1907).

[1] *Underwood Typewriter Co. vs Chamberlain*, 254 US 113, 120 (1920). See also *Butler Bros. vs McColgan*, 315 US 501 (1942); *Bass, Ratcliff & Gretton vs State Tax Commission*, 266 US 271 (1924). It is usually conceded that a corporation may be taxed by its domiciliary state on its entire net income, wherever earned. *Cf. Northwest Airlines vs Minnesota*, 322 US 292 (1944). A contrary rule as to unitary multi-state businesses may, however, be presaged by *Standard Oil Co. vs Peck*, 342 US 382, 384-85 (1952): "The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile . . . . Otherwise there would be multiple taxation of interstate operations and the tax would have no relation to the opportunities, benefits or protection which the taxing states give those operations."

In such a case, profits directly realized, or losses directly sustained, within the taxing state are immaterial. The question is not what income was actually realized, or what loss actually suffered, within the state, but what portion of the over-all net income is attributable to activities pursued therein; and any reasonable formula for determining this income will be sustained in the absence of a clear showing of unfairness.[2]

The corollary—that no state can tax net income in excess of that which may fairly be ascribed to operations within it—was established by *Hans Rees' Sons vs North Carolina*.[3] In that case, the state in which the manufacturing phase—a phase not directly productive of income—was carried on, sought to tax by a formula which attributed to manufacturing operations an unreasonably high proportion of the over-all net income.

In the case at bar, the state in which a phase directly productive of income is conducted seeks to achieve the same end by specific-accounting taxation of all net income directly realized within its borders, without regard for the distinction between realization and attribution of income, and with no provision for apportionment to other

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[2] "Plaintiff rests solely upon the showing that of its net profits $1,293,643.95 was received in other States and $42,942.18 in Connecticut, while under the method of apportionment of net income required by the statute 47 per cent. of its net income is attributable to operations in Connecticut. But this showing wholly fails to sustain the objection." *Underwood Typewriter Co. vs Chamberlain*, 254 US 113, 120 (1920). See *Butler Bros. vs McColgan*, 315 US 501 (1942), in which an apportioned tax was upheld despite the fact that the unitary taxpayer's operations in the state had resulted in a loss.

[3] 283 US 123 (1931).

states of that part of the income at issue attributable to operations in those states.[4]

In both cases, the attempted tax offends due process by reaching extra-territorial values—net income justly attributable to activities conducted in other states.[5] The tax also infringes the commerce clause by exposing an interstate business to the discriminatory burden of multiple taxation.[6]

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[4] "The bare fact of sale produces no income. It is merely the act by which the income is captured; the capital, the organization or efforts which produce the sale, are the things to be considered in ascertaining the amount of income to be credited to the sale. Certainly, in a unitary business, we must look further back than to the sale itself or the activities which actually produce it." *Maxwell vs Kent-Coffey Mfg. Co.*, 204 NC 365, 370, 168 SE 397, 400 (1933), aff'd, 291 US 642.

[5] " 'Taxable event,' 'jurisdiction to tax,' 'business situs,' 'extra-territoriality,' are all compendious ways of implying the impotence of state power because state power has nothing on which to operate. . . . The test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state." *Wisconsin vs J. C. Penney Co.*, 311 US 435, 444 (1940), in which an apportioned supplemental net-income tax was upheld. "The due process clause denies to the state power to tax or regulate the corporation's property and activities elsewhere." *Connecticut General Life Ins. Co. vs Johnson*, 303 US 77, 80-81 (1938). See *Standard Oil Co. vs Peck*, 342 US 382, 384-85 (1952).

[6] For the same reason, unapportioned gross-income and sales taxes on interstate business, when not tied to some local activity not taxable by any other state (see footnote 7 below), have uniformly been held invalid. See *Greyhound Lines vs Mealey*, 334 US 653 (1948); *Freeman vs Hewit*, 329 US 249 (1946); *McLeod vs Dilworth Co.*, 322 US 327 (1944); *Gwin, White & Prince vs Henneford*, 305 US 434 (1939); *Adams Mfg. Co. vs Storen*, 304 US 307 (1938); *James vs Dravo Contracting Co.*, 302 US 134 (1937); *Fisher's Blend Station vs State Tax Commission*, 297 US 650 (1936). An unapportioned tax discriminates against interstate commerce by imposing "upon it, merely because interstate commerce is being done, the risk of a multiple burden to which

Such a tax cannot be maintained on any theory of local event not taxable elsewhere;[7] for it is clear that Louisiana and the other states in which appellant does business are entitled to tax, by apportionment, that part of the net income realized in, and here sought to be taxed in entirety by, Mississippi, which is attributable to operations outside that state.[8]

For example, suppose that an Illinois corporation did all of its manufacturing in Louisiana and made all of its sales in Mississippi. Could Mississippi tax the entire net income on the ground that it was all realized in Mississippi, despite the undoubted right of Louisiana to tax a large part of the same income attributable to the manufacturing processes in Louisiana?

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local commerce is not exposed". *Gwin, White & Prince vs Henneford*, 305 US 434, 439 (1939). See Barrett, *"Substance" vs "Form" in the Application of the Commerce Clause to State Taxation*, 101 University of Pennsylvania Law Review 740, 754-55 (1953).

[7] *Cf. Norton Co. vs Dept. of Revenue*, 340 US 534 (1951); *Interstate Pipe Line Co. vs Stone*, 337 US 662 (1949); *International Harvester Co. vs Dept. of Treasury*, 322 US 340 (1944); *Dept. of Treasury vs Wood Preserving Corp.*, 313 US 62 (1941); *McGoldrick vs Berwind-White Co.*, 309 US 33 (1940); *Western Live Stock vs Bureau*, 303 US 250 (1938). See Note, *State Taxation and Interstate Commerce*, 54 Columbia Law Review 261 (1954). Tying such a tax to a local event not taxable by any other state amounts to apportionment. See Comment, 46 Michigan Law Review 50 (1947).

[8] See footnote 1, page 11 above. The fact that revenue officials in some of the other states have not yet availed themselves of their statutory power to tax appellant by apportionment is immaterial. *Greyhound Lines vs Mealey*, 334 US 653 (1948); *Freeman vs Hewit*, 329 US 249 (1946). *Cf. Northwest Airlines vs Minnesota*, 322 US 292 (1944) and *Dept. of Treasury vs Wood Preserving Corp.*, 313 US 62 (1941), in which the right of any other state to levy a duplicate tax was subject at least to substantial doubt.

Suppose that the present appellant, with its central management and engineering staffs, its storage, construction and supply facilities, and its soil testing laboratory all in Louisiana, had done dredging work only in Mississippi in 1951 or 1953. Would appellant's entire net income be subject to Mississippi taxes, despite Louisiana's right to tax a substantial part of the same income by apportionment?

The Supreme Court of Kansas has pointed out that the difference between such an extreme case and the case here presented is one of degree only, not of principle. In *Montgomery Ward Co. vs State Tax Commission*, that court held unconstitutional an attempt by Kansas to do precisely what Mississippi seeks to do in this case.[9]

The decision below is in direct conflict with the cited Kansas decision, and is irreconcilable with the principle on which this court decided *Hans Rees' Sons vs North Carolina* and all of the other cases disallowing multifold state taxation of multi-state business activities.[10]

Increasing pressures for state revenues stimulate the temptation to tax foreign corporations on operations con-

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[9] 151 Kans. 159, 98 P2d 143 (1940). The opinion contains little discussion of constitutional issues, but it proceeds from the initial premise that "any attempt to tax the income of a nonresident (corporation) derived from sources outside the state would be unconstitutional and void". 151 Kans. at 160, 98 P2d at 144.

[10] "When, as in this case, there are different taxing jurisdictions, each competent to lay a tax with respect to what lies within, and is done within, its own borders . . . the question is necessarily one of apportionment . . ." ***Hans Rees' Sons vs North Carolina***, 283 US 123, 134 (1931).

ducted in other states. Every effort to this end is an incipient barrier to the nationwide free trade and intercourse which the commerce clause was meant to protect.

No unitary multi-state business can long survive if the states in which it realizes income are permitted to levy on the entirety of that income, while the states of its non-income phases—and even states in which income-producing phases have suffered losses[11]—are allowed to reach the same income by apportionment.

The fact that in this case Mississippi, if successful, will exact a net-income tax for a year in which appellant sustained a heavy over-all loss, lends emphasis to the gravity of this issue.[12]

Efforts to tax net income attributable to extra-state activity have increased in recent years. These efforts had, until the decision below in this case, been uniformly rejected by the state courts.[13]

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[11] See footnote 21, page 9 above.

[12] This fact also emphasizes the converse relationship between this case and *Butler Bros. vs McColgan*, 315 US 501 (1942). In the latter case, this court held that a loss suffered in California did not deprive that State of its right to tax, but merely reduced the over-all net profit attributable to, and taxable by, California and all the other states in which the unitary business operated. In this case, profits realized in Mississippi did no more than mitigate appellant's over-all net loss attributable to all the states in which it did business; and provided no basis for constitutional taxation by any of them.

[13] In addition to the case cited in footnote 9, page 15 above, see *Commonwealth vs American Tel. & Tel. Co.*, 382 Pa. 509, 115 A2d 373 (1955); *Celon Co. vs Wisconsin Dept. of Taxation*, 269 Wis. 372, 69 NW2d 453 (1955); *Re Kansas City Star Co.*, 346 Mo. 658, 142 SW2d 1029 (1940); *Artophone Corporation vs Coale*, 345 Mo. 344, 133 SW2d 343 (1939); *Carlos Ruggles Lumber Co. vs Commonwealth*, 261 Mass. 450, 158 NE 899 (1927); all decided on statutory grounds. No decision has been found which concords with that of the Supreme Court of Mississippi in the instant case, with the possible exception of *Dravo Contracting Co. vs James*, 114 F2d 242 (CA 4-1940), cert. den., 312 US 678.

The instant decision of the Supreme Court of Mississippi, if permitted to stand, will serve as an entering wedge of authority for a contrary view. This tendency is subject to ultimate check only by this court, which alone can resolve the conflict of decision, and correct the apparent departure from established constitutional principle, reflected in the judgment below.

It is respectfully submitted that the question presented is substantial, and is of such importance as to warrant plenary consideration by this court.

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APPENDIX

I

Opinion of the Supreme Court of Mississippi

LEE, JUSTICE:

This is an appeal by McWilliams Dredging Company from a decree of the Chancery Court of the First Judicial District of Hinds County, which affirmed, as modified, an additional assessment by the State Tax Commission against it for income taxes for the years 1951 and 1953.

The Company is an Illinois corporation, but has its principal office in New Orleans, Louisiana. During the years in question, it was engaged in the performance of dredging contracts. In 1951, the projects designated as Gulf Coast Sand Beach No. 1, 2 and 3 were performed entirely within the State of Mississippi. In addition, it performed Trunk Line Crossing over the Mississippi River between Mississippi and Arkansas, and Mid-Valley Crossing and Mid-Valley Repairs over the Mississippi River between Mississippi and Louisiana. It had a number of other projects in Illinois, Louisiana and Texas.

In 1953, the Company performed contracts on Pascagoula Road Fill, Jones Cutoff and Biloxi Beach, entirely within the State of Mississippi, and Trunk Line Repairs over the Mississippi River between Mississippi and Arkansas, and Mayersville Crossing over the Mississippi

River between Mississippi and Louisiana. In addition, it had a number of other contracts in Illinois, Louisiana, Texas and North Carolina.

The Company filed its 1951 income tax return within the time provided by law, using a so-called apportionment formula. Thereafter on November 17, 1952, J. A. Hatcher, an auditor in the Income Tax Division of the State Tax Commission, advised the Company that the use of such a formula was discouraged by the Commission; that a direct accounting is better, at least gross sales to gross sales, and inquiring if such basis was possible. On January 22, 1953, H. N. Eason, the Chief of the Division, by letter, called for a response to the previous letter of November 17th. On February 6, 1953, the Company, through its treasurer, J. A. Kincaid, amended its return so as to show the ratio of gross receipts in Mississippi to its total gross receipts, Mississippi's percentage thereof being 20.881, and made an additional payment of $2,148.26. Several conferences occurred thereafter. In the meantime the 1953 return had been filed.

On June 21, 1954, W. L. Perdue of the special audit division of the Commission, following a recent conference, wrote the Company and enclosed a copy of the field auditor's examination. This copy went into great detail both as to the 1951 and the 1953 returns. It set up under schedules 1 and 2 the receipts from the contracts in Mississippi for both years, together with a cost detail in each instance and additional overhead costs, prorated on the basis of direct contract costs, and thus arrived at the

net profits from the operations which were subject to income taxes. The company was advised therein that its income for 1951 in the State should have been reported at $735,697.91 and for 1953 at $99,603.00; that it owed a balance of $44,345.63 for 1951 and $5,534.70 for 1953, including damages and interest; and that the Commission proposed the assessment of an additional tax in those amounts, subject to final determination.

On July 2, 1954, J. A. Kincaid, for the Company, acknowledged receipt of the field auditor's examination, advised that exceptions would be taken, and that, after the writer's return in July, he would contact the Commission for the purpose of a hearing.

A letter by W. L. Perdue to the Company on August 10, 1954, referred to a conference of the day before, and agreed to allow the additional overhead expenses, as claimed. A detailed statement of the basis therefor was enclosed, and it asked that check should be remitted in the sum of $38,763.09. The letter also called for payment of $1,103.68 for 1951 and 1953 franchise taxes.

On August 20, 1954, Kincaid, by letter to H. N. Eason, enclosed the franchise tax as demanded but was indefinite as to his understanding of the basis for the additional amount of income tax.

A letter of H. N. Eason, of date of August 24, 1954, in response to Kincaid's letter of the 20th, advised that his understanding was that information would be submitted to support the company's claim that it belonged in a

separate category from other taxpayers; and that the matter was not disposed of as long as the Company wished to keep it open.

Again, on September 1, 1954, Eason wrote Kincaid, advising that Perdue had accepted the Company's figures in arriving at the additional income tax of $38,763.09.

On September 17, 1954, Kincaid acknowledged receipt of Eason's letters of August 24th and September 1st and indicated his belief that the facts regarding the Company's operations in Mississippi made the state regulations for separate accounting inapplicable, and that it would probably request additional hearings.

On September 22, 1954, Eason acknowledged receipt of the above letter and advised that a hearing would be extended at any time. In justification of the Commission's demand for a separate accounting as to the contracts performed in Mississippi, he said: "It is believed we can prove that you, of necessity, must determine the probable cost of any contract performed at any time in order to bid. Having done so, it would be the height of folly not to maintain an accounting system which would tell you whether or not you had erred in arriving at your bid. Only by such experience can you bid intelligently, and every contractor has and will be required to report on such a basis."

On January 10, 1955, Eason, by letter to the attorneys for the Company, enclosed a detailed amended statement, showing an aggregate liability for 1951 and 1953 income

taxes, including interest to January 15, 1955, of $41,-134.23.

On March 3, 1955, the Company's attorneys asked for a hearing at 9:30 A. M. Thursday March 10th on the Company's income tax matters; and on March 4th thereafter Eason, by letter, advised the attorneys that such hearing would be held as requested.

On the date fixed, the Commission heard the objections to the assessment. The cause was taken under advisement and on April 21, 1955, the Commission entered an order which recited that the cause was heard on March 10, 1955, and was taken under consideration for decision at a later date, and that the Commission "being fully advised in the premises and of the opinion that the said assessment is proper and should be upheld, does hereby sustain and approve the assessment in the following figures and particulars to-wit: Year 1951—additional tax $26,366.83, with interest from March 15, 1952, to date of payment. Year 1953—additional tax $9,795.28, with interest from March 15, 1954 to date of payment."

The appellant maintained in the trial court, and contends here, that the additional assessment for 1951 was not "determined and assessed within three years from the date such was filed", and was therefore barred because under Section 9247 (2), Code of 1942 Anno., "no suit or other proceedings for the collection of any taxes due under the income revenue laws of the state shall be begun after the expiration of three (3) years from the date such return was filed." The section also has a

further provision in these words: "* * * Provided, further, that in the case of a false or fraudulent return with intent to evade a tax or a failure to file a required return, the amount of tax due may be determined, assessed and collected, and a suit or proceedings for the collection of such amount may be begun at any time after it becomes due."

The income tax law contemplated that there would be cases where returns would be filed, and on their face, it would appear that no tax was due, or the proper amount was being paid; but that, on an examination by the Commissioner or his agents, it would be discovered that some tax was due in the first instance, and that more was due than had been paid, in the second instance. Therefore Section 9247 (3) thereof provides: "If upon examination of a return made under this act or income laws heretofore, a tax or a deficiency in tax is discovered, the taxpayer shall be notified thereof and given a period of not more than sixty (60) days after such notice is sent by mail in which to file an appeal and show cause or reason why the tax or deficiency should not be paid. Opportunity for a hearing before the commissioner shall be granted and a final decision thereon shall be made as quickly as practicable, and any tax or deficiency in tax found due after such hearing shall be assessed and paid together with the damages and interest, if applicable thereto, within ten (10) days after notice and demand by the commissioner."

When the auditors checked the 1951 return, they discovered a deficiency in the tax paid—that the Company

had not paid enough tax. Consequently when on June 21, 1954, Perdue wrote the Company and enclosed a copy of the detailed receipts and expenses of the Mississippi contracts, he was proceeding under Section 24, Chapter 120, Laws 1934, and Section 9247 (3) supra, to assess the taxpayer with an additional liability of $44,345.63. This was subsequently reduced to $38,763.09. These figures covered both 1951 and 1953, but of course the statute of limitation had no application whatever to the assessment for 1953. It appeared that negotiations had reached an impasse by January 10, 1955, when Eason affirmed the proposition that $41,134.23, including interest to January 15, 1955, was the amount due.

The acts of Perdue, Eason and other representatives, were the acts of the chairman of the Commission in whom was vested the administration of the income tax laws. The additional assessment by them was an assessment by the chairman. Rigby v. State, 194 Miss. 775, 11 So. 2d 823. If, after notice, there had been no request for a hearing, the assessments would have been final. However, in an effort to set aside and defeat these assessments, the appellant asked for and obtained a hearing before the full Commission. Its objections were overruled. In so doing, the Commission sustained and approved the assessment as theretofore initially made, modified and approved, which had occurred less than three years from the date of the filing of the return. Consequently the statute of limitation had no application.

The additional assessment having been made before the lapse of three years from the date of the return for

1951 income tax, it is not necessary to determine whether or not the chancellor erred in holding, in effect, that the facts in connection with appellant's returns disclosed them to be false or fraudulent within the meaning of Section 9247 (2), supra. For the same reason it is not necessary to consider whether the three year statute was in violation of Sections 100 and 104, Constitution of 1890. These reasons were not stated in the decree as bases therefor. Nor has it been necessary to apply the provisions of Section 25 (2), Chapter 402, Laws of 1942, relative to notice from the commissioner as sufficient to arrest the running of the statute of limitations.

The appellant also contends that its business was a unitary operation, that is, the component parts were so closely connected and necessary to each other that the business could not be divided up into separate units for state income tax purposes.

Section 9222 (1), Code of 1942, Anno., provides for the levy and collection of an income tax on resident corporations, etc.; and (2) thereof says: "A like tax is hereby imposed to be assessed, collected and paid annually at the rate specified in this section and as hereinafter provided upon and with respect to the entire net income, from all property owned and from every business, trade or occupation, carried on in this state by individuals, corporations, partnerships, trusts or estates, not residents of the state of Mississippi."

Under Regulation 9, Article 247, adopted by the Commission in 1949, pursuant to the statutes, foreign corpora-

tions were placed in three classes. Class (1) is not involved here. The description of classes (2) and (3) is as follows: "(2) Those Foreign Corporations or Non-Residents which (who) are created under the laws of another State or Foreign Government and conduct a business or own property within the State of Mississippi and also the same or related business or property without the State of Mississippi but which (who) maintain a system of accounts which will clearly and accurately reflect the net income earned within the State of Mississippi; (3) Those Foreign Corporations or Non-Residents which (who) are created under the laws of another State or Foreign Government and maintain a place of business or own property within this State and also without this State but whose system of accounts will not clearly and accurately reflect the true net income within the State of Mississippi."

Taxpayers in Class (3) therein were further classified as Manufacturing, Trading, and Personal Service and Special cases. It was further provided that,

"Those taxpayers classified under Class (3) above will be required to state in detail why it is necessary to resort to the use of a formula. The Commissioner will accept or reject any return filed on that basis.

"Taxpayers will be placed in Class 3 above only when it is not possible to include them in Classes 1 or 2. The commissioner takes the position that employment of an apportionment formula is, regardless of the refinements or variables used, merely an approximation of the net

income realized from operations conducted within and without the geographical limits of the State of Mississippi. For that reason, the use of an apportionment formula will be discouraged and only in those cases where it is not possible to determine Mississippi net taxable income by the records or accounts of the taxpayer, will such formula be accepted as the basis of measuring the Mississippi income tax liability.

"The Commissioner may, at his discretion, add or change such additional elements or factors as may be determined necessary in arriving at a formula, as set out in this article, and may revise any formula as set out in these Regulations, as will, in the opinion of the Commissioner, properly reflect the income of such taxpayer."

The controversy arose in this way: In its returns the appellant assumed to use the manufacturer's formula, taking the position that the dredge was a floating factory. Originally the appellant made no report whatever of its income from the crossings of the Mississippi River. Its excuse was that it was unable to tell what part of the work was done in Mississippi, Arkansas or Louisiana. Finally, however, it was willing to amend its returns to show a division of this income on a 50% basis between Mississippi and Arkansas and Mississippi and Louisiana. That basis was satisfactory both to the Commission and the taxpayer. In fact there was an agreement to that effect prior to the trial in the court below. Kincaid, in his testimony, admitted that this was a fair distribution.

Out of the 19 projects for 1951, the Company showed gross profits in 18 of them. This was verified by an

exhibit to the testimony of Kincaid. Of the 6 contracts wholly or partly performed in Mississippi, substantial gross profits were shown. The net profits in Mississippi were $409,788.43, and net losses on operations outside the state, by reason of the Chain of Rocks Illinois project in the sum of $592,518.00, amounted to $135,499.83.

In 1953, according to an exhibit to the testimony of Kincaid, the net profits from the 5 operations wholly or partly in Mississippi amounted to $152,434.00, while showing a loss of $920,145.00 by reason of two small losses in Louisiana and a large one of $1,313,549.00 in North Carolina.

The purpose of the state income tax law, insofar as a foreign corporation is concerned, is to tax its income, which is earned in the state. There is no purpose to tax such income where it is earned outside of the state, as this is not permissible. Mississippi Cotton Seed Products Co. v. Stone, 184 Miss. 409, 184 So. 428; Lincoln Life Ins. Co. v. State Tax Commission, 196 Miss. 82, 16 So. 2d 369.

The right of a State to collect a tax on income earned in the taxing state, although the taxpayer is a citizen of a different state, was recognized in Shaffer v. Carter, 252 U. S. 37, 64 L. Ed. 445, 40 S. Ct. 22. That case also settled the question: "That there is no unconstitutional discrimination against citizens of other states in confining the deduction of expenses, losses, etc., in the case of non-resident taxpayers, to such as are connected with income arising from sources within the taxing state, likewise is settled by that decision." Travis v. Yale & Towne Mfg. Co., 252 U. S. 60, 64 L. Ed. 460, 40 S. Ct. 228.

Our law unquestionably favors the specific accounting by foreign corporations. See Regulations 9, supra. It has been well said that "Theories of allocation have no place in determining income tax on corporation, if net income within state can be distinguished from outside business." Magnolia Petroleum Co. v. Oklahoma Tax Commission, et al, 190 Okla. 172, 121 Pac. 2d 1008.

In Butler Bros. v. McColgan, 315 U. S. 501, 62 S. Ct. 704, 86 L. Ed. 991, relied on by the appellant, there was involved a franchise tax based on net income, in which the tax commissioner utilized a formula in accordance with California law. The appellant was engaged in the wholesale drygoods and general merchandise business, having distributing houses in several states, including one in San Francisco. It had a rather complicated system of accounting which showed a loss of $82,851.00 from its operation in the San Francisco house, whereas the operation of all of its houses showed a profit of $1,149,677.00. The tax commissioner under the formula allocated to California 8.1372 percent thereof. The appellant contested this assessment on the ground that, by this formula, a loss of $82,851.00 was converted into a profit of over $93,-500.00 in California. The opinion held that the California statute provided a method of allocation which was fairly calculated to assign to California that "portion of the net income 'reasonably attributable' to the business done there," and that the burden was on the appellant to show that the formula resulted in extraterritorial values being taxed.

In the case here the tax commission did not seek to have a formula upheld. It contended that specific accounting should and could be made. It rejected the company's formula. Consequently the burden was on the Company to show that its extraterritorial values were being taxed or affected. It cannot complain unless it can show that the Commission's method was arbitrary and unreasonable. Bass, Ratcliff & Gretton, Ltd. v. State Tax Commission, 266 U. S. 271, 69 L. Ed. 282, 45 S. Ct. 82.

As has been stated, the formula, upon which the Company based its returns, was applicable to manufacturing. But by no stretch of the imagination could dredging fall into the category of manufacturing.

The Company maintained that its operations were so unitary that it was impossible, from its books, to account specifically on its Mississippi contracts. Yet, by its books it had no difficulty in so accounting to the State of Louisiana for its income in that state.

In bidding on a contract, it was of course necessary for the Company to anticipate and take into consideration all proper expenses and costs in advance in making its bid so that it could insure a profit. If this could be fairly done with reasonable certainty, assuredly the Company could keep up with its receipts and expenses, and reasonably determine, and have reflected in its books, the profit or loss on each particular contract. The auditors of the tax Commission experienced no insurmountable difficulty in ascertaining from the books of the Company its receipts from each project together with expenses properly chargeable thereto.

One serious trouble about the manner in which the Company kept its books was that, although a substantial profit was shown on all of the contracts wholly or partly performed in Mississippi, yet, by insisting that it had the right to charge to the Mississippi projects an unreasonable amount of the so-called "idle shop account", it attempted to cancel out a large part of its Mississippi income. Since it had a number of other projects, the Company was not entitled to attribute to its Mississippi contracts an undue proportion of this account.

The fact that such an over-all return on the Company's business, so far as federal income is concerned, might be proper or acceptable for that purpose is no reason why it should be applicable insofar as state income is concerned. If the laws or conditions in this state were perhaps more conducive to the earning of profits than elsewhere, nevertheless this should not have the effect of penalizing this State by taking the income earned here to replenish the Company's coffers, which had been exhausted by loss from profligate or improvident contracts elsewhere.

The final decree determined the taxable income for both 1951 and 1953, computed the taxes which were due thereon, credited the amounts previously paid, modified the order of the Commission so as to conform thereto, and gave final judgment for $32,916.98, plus interest to accrue.

From what has been said, it follows that the decree of the trial court should be and is affirmed.

AFFIRMED.

II

Opinion of the Chancery Court for the First Judicial District of Hinds County

The Court having heard and carefully considered the evidence presented in this cause and having heard argument of Counsel, is of the opinion, and so finds, that the Petitioner deliberately set out to beat the State of Mississippi out of certain income taxes rightfully due and owing as a result of income derived from the use of equipment owned by said Petitioner and services rendered by said Petitioner in the State of Mississippi during the years 1951 and 1953, the undisputed evidence clearly establishing that the Petitioner, in filing its income tax returns to the State of Mississippi for said years, 1951 and 1953, failed to show in said returns many thousands of dollars of income derived from work done in connection with various pipeline installations across the Mississippi River, and further showing in said tax returns as items of cost charged against the Mississippi income, all idle plant costs for the entire operations of the Petitioner, it being obvious to the Court and, in fact, admitted by the Treasurer and principal witness of the Petitioner, that there was absolutely no justification for the setting up of all of this idle plant cost against the income derived from work done within the State of Mississippi when, in fact, the Petitioner had many other jobs in places outside the State of Mississippi. This conclusion is further supported by the evidence presented in this cause wherein the Petitioner contends that, due to the nature of its business, it was impossible for it to file its income tax re-

turns to the State of Mississippi for said years of 1951 and 1953 on a separate accounting basis when, in fact, the same Petitioner did file on separate accounting basis income tax returns and pay income taxes to the States of Louisiana and Arkansas for income derived for said periods through the use of equipment and the furnishing of services of the same nature and character as those from which income was derived in the State of Mississippi for said years.

The Court concludes as a matter of fact and law that the business of the Petitioner as operated during the years 1951 and 1953 was not unitary to the extent that it was impossible for it to fairly and equitably prepare, file and pay income taxes to the State of Mississippi on a separate accounting basis, the proof showing conclusively that the auditors of the Respondent, State Tax Commission, had little or no trouble in determining from the books and records of the Petitioner, which had been kept and maintained in regular course of business, the taxable income derived from its operations exclusively within the State of Mississippi, and by mutual agreement apportioning to the State of Mississippi 50% of the income received from the Mississippi River crossing jobs, on a separate accounting basis.

It is very apparent to this Court that the Petitioner seeks, in the filing of its returns and payment of its income taxes to the State of Mississippi on the formula basis, to take advantage of the tremendous loss which the company sustained on a job done on the Mississippi River near the City of St. Louis during the year 1951

and to take advantage of a still greater loss on a job done by said company at Wilmington, North Carolina in the year 1953. It is the opinion of this Court that it would be extremely unfair, highly inequitable and grossly unjust to the State of Mississippi to permit the Petitioner to charge against the wonderful profits, which it made on the jobs performed in the State of Mississippi, those tremendous losses on jobs performed elsewhere.

The Court, therefore, concludes that the Petitioner, McWilliams Dredging Company, is not entitled to the relief prayed for, and said Petition should be and is hereby dismissed at the cost of the Petitioner. However, it is the opinion of this Court that the Order of the Respondent, State Tax Commission, dated April 21, 1955, assessing additional income taxes against the Petitioner for the years 1951 and 1953 should be and will be affirmed, subject to the necessary modifications to show the principal amount of income taxes and interest due to conform to the evidence presented in this case as shown by Exhibits Nos. 4 and 7 to the Answer of the Respondent, State Tax Commission.

So ordered.

III

Judgment of the Supreme Court of Mississippi

This cause having been submitted at a former day of this term on the record herein from the Chancery Court of the First Judicial District of Hinds County and this

court having sufficiently examined and considered the same and being of the opinion that there is no error therein doth order and adjudge and decree that the decree of said Chancery Court rendered in this cause on the 3rd day of October 1955—be and the same is hereby affirmed. It is further ordered and adjudged and decreed that the appellee do have and recover of and from the appellant, McWilliams Dredging Company, and Seaboard Surety Company of New York, New York, surety on the supersedeas appeal bond herein, the sum of $32,916.98 the amount of the decree in the court below, together with interest thereon at the rate of 6 per centum per annum from October 3, 1955 until paid, also the further sum of $1,645.85 being damages at the rate of 5 per centum as allowed by statute, and all of the costs in this court and in the court below to be taxed, etc., for which let execution issue.

IV

Decree of the Chancery Court for the First Judicial District of Hinds County

This day this cause came on for hearing and petitioner and respondent having entered their appearance through counsel, and the Court having heard evidence for the petitioner and respondent and argument of counsel, and being fully advised in the premises and being of the opinion that the Order of the State Tax Commission should be modified and affirmed:

IT IS, THEREFORE, HEREBY ORDERED, ADJUDGED and DECREED that this Court has full and complete jurisdiction, both of the parties and of the subject-matter, of this controversy.

IT IS FURTHER HEREBY ORDERED, ADJUDGED and DECREED that the Order of the State Tax Commission dated April 21, 1955, "IN THE MATTER OF THE PROPOSED ASSESSMENT OF INCOME TAX AGAINST McWILLIAMS DREDGING COMPANY, NEW ORLEANS, LOUISIANA, FOR THE YEARS 1951 AND 1953", be modified and affirmed as so modified.

IT IS FURTHER ORDERED, ADJUDGED and DECREED that the aforesaid Order of the State Tax Commission be modified and affirmed as follows:

Year 1951:			
Amended Net Income..		$409,788.43	
Tax on first	$ 25,000.00	890.00	
Tax at 6% on	384,788.43	23,087.31	
Total		23,977.31	
Tax previously paid ..		4,632.19	
Additional tax due ...		19,345.12	
Interest @ ½ of 1% per month		4,159.20	
Additional Tax and Interest for 1951			$23,504.32

Year 1953:			
Amended Net Income ..		152,434.00	
Tax on first	25,000.00	950.00	
Tax at 6% on	127,434.00	7,646.04	
Total		8,596.04	
Tax previously paid ..		-0-	
Additional tax due		8,596.04	
Interest @ ½ of 1% per month		816.22	
Additional Tax and Interest for 1953			9,412.66
Additional Tax and Interest due for 1951 and 1953			32,916.98

IT IS FURTHER ORDERED, ADJUDGED and DECREED that respondent, Alex McKeigney, Chairman, State Tax Commission, do have and recover of the petitioner, McWilliams Dredging Company, New Orleans, Louisiana, and its bondsman, Seaboard Surety Company of New York, the sum of $32,916.98 plus all statutory interest from date of this decree to date of payment and all costs incurred herein, for which and all of which let execution issue.

ORDERED, ADJUDGED AND DECREED on this 3rd day of October, 1955.

/s/ L. Arnold Pyle
CHANCELLOR

V

State Statutes Involved

Section 11(1)(c) of the Mississippi Income Tax Acts of 1934 and 1952:

In the case of gross income derived from sources partly within and partly without the state, the net income may first be computed by deducting the expenses, losses, or other deductions apportioned or allocated thereto, and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income; and the portion of such taxable income attributable to sources within the state may be determined by processes or formulas of general apportionment, prescribed by the commissioner, with the approval of the governor.

Article 247 of Mississippi Income Tax Regulations 9 of 1949 and 10 of 1952:

ARTICLE 247. Taxable Net Income of Foreign Commercial Taxpayers—For the purpose of Section 11, of the Act, Foreign Corporations as defined in Section 2(c), of the Act, and Non-Residents as defined in Section 2(f) of the Act, will be classified as follows:

(1) Those Foreign Corporations or Non-Residents which (who), while in fact created under the laws of another State or Foreign Government, actually maintain their principal seat of business, or all of whose property is located within the State of Mississippi and have no branches

or property without the State of Mississippi and conduct all of their business from within this State.

(2) Those Foreign Corporations or Non-Residents which (who) are created under the laws of another State or Foreign Government and conduct a business or own property within the State of Mississippi and also the same or related business or property without the State of Mississippi but which (who) maintain a system of accounts which will clearly and accurately reflect the net income earned within the State of Mississippi.

(3) Those Foreign Corporations or Non-Residents which (who) are created under the laws of another State or Foreign Government and maintain a place of business or own property within this State and also without this State but whose system of accounts will not clearly and accurately reflect the true net income within the State of Mississippi.

Class (1) Taxpayers above must report their income on the return blank IT—Form 301.

Class (2) taxpayers above must report their taxable income on the return blank IT—Form 301 and such return must be accompanied by a full supplementary schedule and statement indicating clearly the manner after which such net income was determined.

Taxpayers in Class (3) above will be further classified into the following identifications:

(A) MANUFACTURING.

(B) TRADING.

(C) PERSONAL SERVICE AND SPECIAL CASES.

(a) The apportionment ratio to be used in MANUFACTURING identifications of the Foreign Corporations class will be determined by the use of the formula which is as follows:

(1) Property (average at beginning and end of taxable period) owned or used in business.

(2) Expenditures for Labor (Direct and Indirect).

(3) Sales.

Determination of the ratio of each of these factors within Mississippi as related to the total of each for the total operation.

(4) Sum of the ratios determined under lines 1, 2, and 3.

(5) Average ratio within Mississippi (1/3 of line 4).

Property—The first element of the formula "property" includes lands, buildings, machinery, equipment, and other tangible personal property actually used in manufacturing or producing the articles or commodities

manufactured. Appreciation must be eliminated from book values for purposes of apportionment and the value at which tangible property should be included in the apportionable factor is the average cost at the beginning and end of the taxable period. The figures used shall include cost less depreciation or depletion sustained. Assets which produce nonapportionable or nontaxable income should not be included in the figures employed in this element of the formula. Inventories, cash on hand or in banks, stocks, notes, bonds, accounts receivable, notes receivable, privileges, franchises, and good will are specifically excluded from the capital assets element of the formula.

Expenditures for Labor—The percentage which the taxpayer's wage, or other compensations, paid or incurred in this State, or paid in respect to direct and indirect manufacturing labor performed in this State, in connection with said trade or business done by such taxpayer in this State, is to the taxpayer's total wages, in respect to direct and indirect manufacturing labor, paid or incurred in connection with said entire trade or business.

Sales—The term "sales" is defined as gross receipts from sales assignable to offices, agencies or places of business within the State; provided such receipts shall be assigned to that office, agency or place of business at or from which they are chiefly negotiated and executed; and at or from which the principal activity leading to the sale was carried on.

(B) Taxpayers carrying identification of TRADING from Class (3) above will use an apportionment ratio, which is determined after the manner which follows:

Sales: Within Mississippi as related to total sales.

This formula must be adhered to unless the Commissioner shall grant special permission to employ an alternative formula.

(C) Those taxpayers identified as PERSONAL SERVICE and SPECIAL CASES under Class (3) above mentioned must determine their net income from within Mississippi after the manner in which the accounts for such taxpayers are kept. The net income in such instances will be determined in the light of particulars attaching to the taxpayer. When such income is determined in this manner, full explanatory schedules must be submitted in support thereof. The Commissioner will accept or reject such apportionment on its merits.

The apportionable profit will be determined from the total net income for the year as reported on the return blank prescribed. This total net income will be, Federal net income, plus deductions not allowable, and less income not taxable under the Mississippi Income Tax Law. There will be deducted therefrom interest received, provided, however, that interest income will first be reduced by the amount of interest paid; all rentals and royalties; all profits from sales of capital assets; all salaries, wages and compensation received for other personal services and all other income earned directly from sources without the State.

There will also be deducted therefrom, and allocated directly to Mississippi, similar items realized from sources within the State of Mississippi. Intangible income will be considered Mississippi income in those cases where the evidence of ownership has acquired a business situs within the State of Mississippi.

To the foregoing, there will be added taxes paid (other than Federal and State income taxes and Local Benefit Taxes) interest, rents and royalties, and all other expenses not related to the unitary or apportionable income.

Such expenses, applicable to the non-unitary Mississippi operations, will be deductible from the net profits allocated in Mississippi.

Those taxpayers classified under Class (3) above will be required to state in detail why it is necessary to resort to the use of a formula. The Commissioner will accept or reject any return filed on that basis.

Taxpayers will be placed in Class 3 above only when it is not possible to include them in Classes 1 or 2. The Commissioner takes the position that employment of an apportionment formula is, regardless of the refinements or variables used, merely an approximation of the net income realized from operations conducted within and without the geographical limits of the State of Mississippi. For that reason, the use of an apportionment formula will be discouraged and only in those cases where it is not possible to determine Mississippi net taxable income, by the records, or accounts of the taxpayer, will

such formulae be accepted as the basis of measuring the Mississippi income tax liability.

The Commissioner may, at his discretion, add or change such additional elements or factors as may be determined necessary in arriving at a formula, as set out in this article, and may revise any formula as set out in these Regulations, as will, in the opinion of the Commissioner, properly reflect the income of such taxpayer.

VI

Specification of Error Filed in the Supreme Court of Mississippi (Excerpt):

"The lower court erred in holding that the Mississippi State Income Tax Act of the Laws of 1942 as amended by Title 36, Chapter 1, Income Tax Act of 1950, Sections 9220-9259, permit assessment of appellant on a specific accounting basis, if, however, said section does permit assessment of appellant on a specific accounting basis, said section and the act and decree are unconstitutional as violative of Section 1 of the Fourteenth Amendment of the Constitution of the United States and of the 'commerce clause' of the Constitution of the United States, Paragraph 3, Section 8."

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FILED
JUL 23 1956
JOHN T. FEY, Clerk

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1956

NO. 226

WILLIAMS-McWILLIAMS INDUSTRIES, INCORPORATED ..... *Appellant*

Versus

ALEX McKEIGNEY, CHAIRMAN STATE TAX COMMISSION OF THE STATE OF MISSISSIPPI ..... *Appellee*

APPEAL FROM THE SUPREME COURT OF THE STATE OF MISSISSIPPI

MOTION TO DISMISS OR AFFIRM

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Appellee, pursuant to Rule 16 of the Revised Rules of the Supreme Court of the United States, moves that the final judgment of the Supreme Court of Mississippi be affirmed on the ground that the question is so unsubstantial as not to warrant further argument.

I.

STATEMENT OF FACTS AND ISSUES ON APPEAL

This is an appeal from a decision rendered by the Supreme Court of the State of Mississippi on the 16th day of April, 1956, and reported at 86. So. (2d) 672, (Advance Sheet) wherein it was held that appellant's predecessor was liable to the State of Mississippi for an additional assessment of income taxes for the years 1951 and 1953.

Appellant, an Illinois Corporation, during the years herein involved was engaged in the State of Mississippi in the business of dredging operations both in the Mississippi River and along the Mississippi Gulf Coast as well as in other parts of the country. Appellant vacillated considerably over a long period of time in the methods employed by it in computing its income taxes due not only to the State of Mississippi but also in regard to State income taxes due other states as well. Appellant first filed its returns in Mississippi by using a manufacturers formula[1], taking the position that a dredge was afloating factory[2]. The second return was filed on the basis of gross receipts, in and out of the state[3]. True, appellant claimed this was on the advice of appellee's agents but the whole testimony definitely points to the fact that appellee never varied from its position that the correct method for appellants use in filing was by means of specific or direct accounting[4]. Appellant's testimony was that it could not file its income tax returns with Mississippi on a direct accounting basis[5], yet for the very years involved in this suit it did file on a direct accounting basis with the State of Louisiana[6], while protesting its sincerity it failed to report to Arkansas any income, even on a formula basis[7], although one of its operations was a crossing of the Mississippi River from the State of Arkansas to the State of Mississippi[8]. Appellant filed four returns for the same year on its own[9], one return

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1—Tr 127
2—Tr 176—As to which see 16 Words & Phrases, Permanent Edition page 30—"A tug boat used in dredging operations is not a factory . . ."
3—Tr 127
4—Tr 130
5—Tr 200
6—Tr 261, 262
7—Tr 247
8—Tr 247
9—Tr 246

being filed in the trial court during the progress of this cause[10].

In regard to income earned on the river crossings, appellant first took the position that it owed no taxes on the income thus earned[11], because it claimed the Mississippi River was a Federal tributary[12], then abandoned that position, taking the position that this income should be divided half to the State of Mississippi and half to the other state[13], and even entered into a written stipulation thereon[14], but now seems to be attempting to again reverse its position.

The crux of the suit, other than the credibility of the witnesses, was whether the taxing authorities of the State could require appellant to pay taxes on the income it earned in the State of Mississippi by use of specific accounting.

II.

A STATE MAY EMPLOY ANY METHOD IT CHOOSES TO ASCERTAIN INCOME EARNED WITHIN THE STATE

It has been held even from an early date that the right of a state to tax is not confined to its people and their property, but; "It may be exercised upon every object brought within its jurisdiction." *McCulloch vs. Maryland*, 4 Wheat. 316, 429, and the imposition of income taxes is a recognized means of taxing those earning money

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10—Tr 186-189
11—Tr 247
12—Tr 9
13—Tr 247
The Western boundary of the State of Mississippi is the thread of the Mississippi River. Art. 2 Sec. 3 Mississippi Constitution of 1890; Iselin vs. La Coste 139 F(2d) 387 cet. den. 321 U. S. 790; Anderson-Tully Co. vs. Tingle 166 F(2d) 224 cet. den. 335 U. S. 816
14—Tr 170

within the jurisdiction. *Shaffer vs. Carter,* 252, U. S. 37, 51. The imposition of direct accounting as a basis for computing income earned within the state does not constitute unconstitutional discrimination. *Travis vs. Yale and Towne Manufacturing Company,* 252 U. S. 60, 75

> ". . . there is no unconstitutional discrimination against citizens of other states in confining the deduction of expenses, losses, etc., in the case of non-resident taxpayers, to such as are connected with income arising from sources within the taxing state . . ."

When a state has adopted a method of ascertaining the income earned therein which method does not assign a disproportionate part of the tax payers income to the state and is not discriminatory, it will be sustained. *Hans Rees' Sons vs. North Carolina ex-rel Maxwell* 283, U. S. 123, 133

III.

APPELLANT'S OPERATIONS ARE NOT UNITARY SO AS TO REQUIRE USE OF ALLOCATION FORMULA

Appellant's operations are not unitary but of course, there is no magic in the use of a label and this court may go behind a label at its discretion.[15] Rather than quibble over definitions regarding the use of the term "unitary operations" an examination will show that in cases where this court has upheld the use of an allocation formula that the taxing authorities have imposed, the tax payers operations were such that different operations in separate states made direct contributions to the earning of income. In one case[16] there was "Buying

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15—Railway Express Agency Inc. vs. Virginia 347 U. S. 359

16—Hans Rees' Sons vs. North Carolina ex-rel Maxwell 283 U. S. 123, 127

profit; Manufacturing profit; and Selling profit" derived from operations carried on in the States of New York and North Carolina.

In another the profits of the corporation[17] were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other states.

Another[18] presented a situation in which the taxpayer did all its brewing in England but part of the sales took place in this country.

The fact that one state may require the use of an apportionment formula in a particular situation and this court approves[19], does not require all states to use the same method or the same formula so long as each state taxes only that income earned within its borders.

Appellant is not engaged in manufacturing and selling but is engaged solely in the localized business of dredging and its income is earned where the dredging is done[20]. The fact that appellant was engaged in dredging operations in various states during the same year would no more affect its tax liability in this case than would the fact that it owned real and personal property in several states on the ad valorem tax lien date. It would owe taxes to each state on the entire value of its property located there, regardless of the fact that it owned property in other states which it used in its business. Appellant's income for each of its dredging operations was proved by its own records[21] which, although it called such records merely statistical information, did tie into its regular

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17—Underwood Typewriter Co. vs. Chamberlin, 254 U. S. 113, 120
18—Bass, Ratcliff and Gretton vs. State Tax Commission, 266 U. S. 271, 278
19—Butler Brothers vs. McColgan, 315 U. S. 501
20—James vs. Dravo Contracting Co., 302 U. S. 134, 153
21—Tr 200-236

books of account, according to appellant's own admission[22]. Appellant admitted that its overhead by its records was allocated to various contracts[23]. Appellant's records being kept as they were, there can be no doubt of the correctness of the use of specific accounting.

Fisher vs. Standard Oil Company 12 F (2d) 744:
". . . Theories of allocation can have no place in the inquiry, if net income within the State stands on its own footing, unmixed with outside business . . ."
Magnolia Petroleum Company vs. Oklahoma 121 P (2d) 1008:

"Before a system of indirect allocation may be adopted, the Commission must be faced with the impossibility of allocating specifically the profits earned by the processes and the facilities operating within the state."

True, there was central management, which may permit a state to impose the use of an allocation formula where a buying profit is involved in a business whose income is derived from more than one operation[24], but does not so require, particularly when the state's announced public policy is to encourage specific and direct accounting rather than the use of allocation formulae[25].

Appellant claims that Louisiana is entitled to tax a part of the income here taxed by Mississippi:

22—Tr 258, 261
23—Tr 140-141-142
24—Hans Rees' Sons vs. North Carolina ex rel Maxwell 283 U. S. 123, 132—". . . The petitioner was not exclusively a hide dealer or a mere tanner of leather or a leather salsman . . ."
25—Exhibit "3" to defendant's answer and
—Tr 289-290 Regulations 9, Art. 247 State Tax Commission: " . . . The Commissioner takes the position that employment of an apportionment formula is, . . . merely an approximation of the net income realized from operations conducted within and without the geographical limits of the State of Mississippi. For that reason, the use of an apportionment formula will be discouraged . . ."

"... for it is clear that Louisiana and the other states in which appellant does business are entitled to tax, by apportionment, that part of the net income realized in, and here sought to be taxed in entirety by, Mississippi, which is attributable to operations outside that state[26]".

Appellant paid income taxes to the State of Louisiana for the years herein involved on a direct accounting basis, therefore, Louisiana would not be entitled to an apportionment of income earned in other states. There can, therefore, be no discrimination against the State of Louisiana and there was also no showing by appellant that it paid income taxes to any state other than the State of Mississippi on any basis other than by use of direct accounting. It neither paid nor reported income to the State of Arkansas by apportionment or otherwise on income earned by it in dredging from the Arkansas to the Mississippi bank of the Mississippi River[27].

IV.

INTERSTATE COMMERCE IS NOT INVOLVED IN THIS CASE

Even if interstate commerce were involved herein, it has become axiomatic that interstate commerce may be made to pay its way.

Western Livestock vs. Bureau of Revenue, 303 U. S. 250, 254.

McGoldrick vs. Berwind-White Coal Mining Co. 309 U. S. 33:

"... A tax may be levied on net income wholly derived from interstate commerce ..."

26—Jurisdictional Statement P. 14
27—Tr 247

U. S. Glue Co. vs. Oak Creek 247 U. S. 321.

The mere fact of federal regulation does not preclude state taxation[22]. Taxation of the income from the performance of a dredging contract within the State of Mississippi does not unduly burden interstate commerce.

James vs. Dravo Contracting Co. 302, U. S. 134, 153:

> "The question of the tax liability of a contractor upon the fruits of his service is closely analogous to that of the taxability of the property of the contractor which is used in performing the services . . ."

The transportation of equipment, and the upkeep thereof is purely incidental to the performance of a local act. *General Railway Signal Company vs. Virginia* 246, U. S. 500; *Browning vs. Waycross*, 233 U. S. 16.

The erection of a bridge by a foreign corporation contemplates local activity. *Kansas City Structural Steel Company vs. Arkansas* 269, U. S. 148.

Wherefore premises considered, appellee prays that the appeal in this case be dismissed or that the judgment of the Supreme Court of the State of Mississippi be affirmed.

Respectfully submitted,

John E. Stone
Attorney for Appellee

22—Polish National Alliance vs. National Labor Relation Board 322 U. S. 643, 649.

I, John E. Stone, Attorney for the Appellee in this cause certify that I have, this day, mailed, postage prepaid, to Deutsch, Kerrigan & Stiles, Hibernia Bank Building, New Orleans 12, Louisiana, a true and correct copy of the above and foregoing.

This the.....day of July, 1956.

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JOHN E. STONE

No. 226. WILLIAMS-McWILLIAMS INDUSTRIES, INC., *v.* McKEIGNEY, CHAIRMAN, STATE TAX COMMISSION. Appeal from the Supreme Court of Mississippi. *Per Curiam:* The motion to dismiss is granted and the appeal is dismissed for want of a substantial federal question. *Eberhard P. Deutsch* and *René H. Himel, Jr.* for appellant. *John E. Stone* for appellee. Reported below: — Miss. —, 86 So. 2d 672.